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The Importance of a Medium-Term Budgetary Framework in Enhancing the Sustainability of Public Finances in Romania

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Abstract

The reform that the romanian fiscal system should follow aims to increase the quality of public finances and fiscal governance and strengthening fiscal discipline through better management of budgetary resources. This can be achieved by taking legislative and institutional measures, such as a new law on fiscal responsibility, developing a long-term fiscal strategy, moving to a multi-annual budget programming by implementing a medium-term budgetary framework, the introduction of strict fiscal rules and the establishment of an Independent Fiscal Council. The purpose of this paper is to highlight the importance of adopting a medium-term budgetary framework by Romania and the role that this public fiscal management tool plays in the development of budgetary procedures to ensure fiscal discipline and sustainability of national public finances.

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Keywords: medium-term budgetary framework, quality of public finances, sustainability of the fiscal system, fiscal governance.

1. Introduction

One of the great challenges of national economies today is to ensure competitiveness in international markets, together with the establishment of a financial framework to support social and economic development and progress, to provide a continuous opening outwards, framework that shows that for public and private finances are all dependent on European and international context.

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Sustainability of public finances, concept that is imposed by the economic realities in substantiation of any state's financial policy, must take into account the international context and reporting to the development needs of the system of international relations, this is why the study of public finances represents a very complex and current domain.

Government policies are financed by the public budget, which is formed by each government through the tax system, social contributions and other levers of control the public resources to the national budget. Ways in which governments finance their own activities (taxes, loans, etc.), size, pattern and functions assumed by them in government spending can decisively influence social and economic life within those states, and the events at European and international level. (Stanciu, 2012, pg.190)

The role and importance of public finance in the economic development of a country are very complex and have a major impact on the sustainability of the tax system and its components. For public finances to achieve their purpose, each state shall outline the fiscal strategy by which to achieve specific objectives according to national development needs. One of the major challenges that the adoption of a fiscal strategy encounter is predictability and consistency in the implementation of fiscal policy. This is particularly important in ensuring an optimal climate for economic development of a country, designed to provide potential investors placing funds safety.

One of the essential elements that fiscal policy provides is the preparation of the annual budget, which must usually cover a time horizon of 3-4 years, to ensure budget consistency. Given this goal, the governments of the states in the European Union, have adopted in preparing the annual budget, a medium-term budgetary framework - MTBF.

The medium-term budgetary framework (MTBF) appeared in public finance practice in different countries in order to strengthen fiscal discipline, consistency, accountability and increase transparency of the budget process. In general, the MTBF has been introduced in all countries with budget deficits, public debt levels, respectively, high or go through periods of crisis.(European Institute of Romania, 2009, pg.25).

If we refer to the current context, in which the world's economies are hit by the economic crisis, adopting a medium-term budgetary framework becomes necessary to substantiate any state fiscal policy. Regarding Romania, it should be noted that fiscal and budgetary discipline has never been a strong point for our country, and with the accession to the European Union, Romania must align to the standards of the macroeconomic policy and fiscal policy that the European Commission promotes.

1. Context of implementing medium-term budgetary framework

The objectives that the European fiscal policy proposes, are often mentioned in the treaties of accession to the European Union, as well as in the recovery programs required by the global financial crisis and adopted at national level by many countries on the recommendation of international bodies such as the European Commission International Monetary Fund, OECD, World Bank, etc. . Regarding national fiscal policy, a major factor in ensuring the effectiveness of fiscal policy is the assurance and continuous quality improvement of public finances.

The concept of quality of public finances is promoted by the European Commission through the Stability and Growth Pact, revised in 2005. According to this pact, transparency and predictability of fiscal policy are the main guidelines in the foundation of national fiscal strategies, as knowing the quality and stability of a country's macroeconomic environment is essential for business area. In defining this concept, the European Commission discusses a key element of the quality of public finances, that is represented by fiscal governance.

Fiscal governance represents the assembly of budgetary and fiscal rules used by a country, together with the procedures and regulations used in the preparation, adoption and monitoring of budget processes. Achieving fiscal governance quality implies a fiscal strategy well-grounded in scientifically and praxiological area, the existence of clear fiscal policy rules, which are supported by law and the existence of an Independent Fiscal Council that oversees the entire fiscal policy, together with the Government. (European Institute of Romania, 2009, pg.7-8)

Under the approach of the European Commission, fiscal governance is characterized by the simultaneous existence of three variables:

- the existence of a medium-term budget framework (MTBF);
- Fiscal policy rules applicable national uniform;
- the existence of an Independent Fiscal Council.

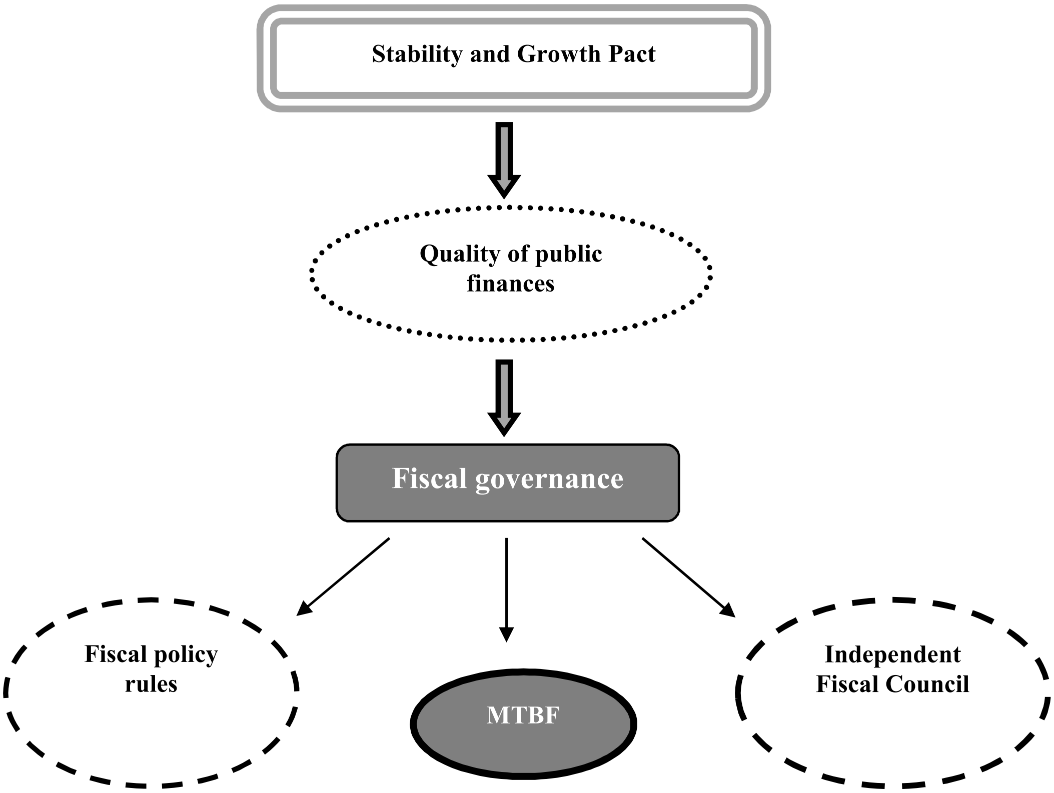

Figure 1. The Context of implementing a medium-term budgetary framework

Component of fiscal governance, the medium-term budgetary framework brings many advantages in terms of improved budgetary practice , such as:

- it has a positive impact on increasing the transparency of fiscal policy with direct implications for improving awareness of the business environment;
- via it's components it provides to the authorities responsible for substantiating the public fiscal policy, the tools to improv the public budget programming and the public expenditure management;
- it supports structural reforms and harmonization with the European fiscal system;
- it provides predictable macroeconomic environment by ensuring continuity in adopting and implementing fiscal policies;
- it imposes fiscal discipline through the fact that public resources must be properly allocated on budget expenditures that are related to activities that continue from previous years and follow the set objectives;
- it involves the improvement and modernization of the budget by introducing a program-based budget classification, which involves not only emphasizing budgetary expenditure on administrative and territorial units, but also the types of programs designed to achieve the national defined targets such as economic growth, employment growth, infrastructure development, etc. .

The usage of a medium-term budget framework is not a very recent practice, many Member States of the European Union, have been using this concept in their national public finance practice long ago before this instrument has become a priority of the Stability and Growth Pact developed by the European Commission. Thus Sweden has introduced in its fiscal policy a medium term budget framework on a horizon of 3 years since 1997 in response to fiscal and financial crisis that it has traversed in the early 90s. Also among northern states that have adopted a multi-annual budgetary framework are the Netherlands, in 1994 and Finland in 1995, the measure being taken to support national governments to overcome the economic downturn by imposing fiscal discipline and fiscal reform aimed to ensure fiscal stability.

The proper approach of the medium-term budgetary framework among member states of the European Union was introduced by the UK in 1998, by adopting two rules for fiscal discipline called "golden rule" and "sustainable investment rule". These two rules were the pillars on which the public expenditure planning was substantiated on a horizon of three years. Taking the model of English, Spanish fiscal practice introduces the medium-term budgetary framework in 2001, aiming both to balance the budget and achieve a low level of deficit.

Currently, introducing this concept in the fiscal practice of national governments has become a prerequisite for the member states of the European Union, being only a matter of time before the implementation of this budget management tool becomes a reality of their public policy. Harmonization of national fiscal policy with the European standardization may not impose a common fiscal policy, given the specific features of each Member State but has a major role in the compatibility of national fiscal systems in order to achieve common goals established by treaties. Therefore fiscal practice shows that the approval of the medium-term budgetary frameworks should take into account the particularities of each country, as well as the institutional and legislative traditions and mechanisms of fiscal policy.

The main criterion for the classification of MTBF is related to the capacity of ensuring the continuity of the budget process applied in each state. From this point of view there are two types of MTBF:

- flexible MTBF;
- fixed MTBF.

Flexible MTBF refers to the fact that the annual review of the overall objectives can be adjusted according to the development mode of the economy or changes in fiscal policy.

Fixed MTBF remain unchanged throughout the time horizon for which they were taken, unless force majeure occur, such as the emergence of a major economic recession, changes of government, etc..

Given the many advantages that the adoption of a medium-term budgetary framework entails, national governments are responsible for introducing an appropriate legal framework to ensure the implementation of the fiscal strategy of the country.

2. The adoption of a medium-term budgetary framework by Romania

Once Romania joined the European Union in 2007, the fiscal harmonization of national fiscal policy has become a priority in order to establish national public finance sustainability. According to Directive 2011/85/EU of the European Council from 8th of November 2011 on requirements for budgetary frameworks of the Member States: “the approval of the annual budget law is the most important stage of the budget process because during this step, Member States adopt important budgetary decisions, most fiscal measures with budgetary implications beyond the annual budget cycle. A one-year horizon therefore provides a poor basis for sound budgetary policies. To embed multi-annual budgetary perspective of the budgetary surveillance framework of the Union, the annual budget planning legislation should be based on multiannual fiscal planning stemming from the medium-term budgetary framework” (Directive 2011/85/EU of the European Council) .

Regarding Romania's experience in adopting a medium-term budgetary framework, we notice that the steps taken in this regard have not resulted in a multi-annual budget planning to meet the requirements of successful implementation of this concept.

Since 2007, the organization of public finances in Romania have to take into account the creation of a medium-term fiscal strategy, on a time horizon of three years, to ensure continuity of the approaches in achieving national targets assumed, but we cannot speak about the implementation of a medium-term budgetary framework itself. This is due to several factors, both organizational, administrative, and legislative, that represent weaknesses of the management institutions involved in substantiating fiscal policy. From the administrative point of view, it may be noted the lack of adoption of fiscal policy that should be characterized by consistency, stability and predictability in the development of projects of the Tax Code to ensure consistent harmonization and integration with the EU directives and economic realities. It should also be noted that Romania should seriously focus its attention in establishing an

Independent Fiscal Council, which would have the power to review the budgetary impact of proposals to amend the budget due to unforeseen events.

From a legislative perspective, it can be seen that the lack of successful implementation of medium-term budgetary framework in Romania is due to lack of ability to achieve high accuracy predictions on a horizon of at least 3 years, with no fiscal rules and budgeting fiscal regulations that would constitute the main pillars in the development of a sustainable national taxation system.

Given the specificity of the Romanian economy and the main vulnerabilities of the Romanian fiscal system, we believe that for our country the best option is to consider a fixed MTBF ceilings on budgetary indicators, and a sliding one if we refer to the horizon operation, meaning that at the end of each year the new year is being taken into the time horizon. In this way we can ensure coordination of annual budgets in the medium term budgetary framework.

3. Conclusions

Adopting a medium-term budget framework is a challenge for any state. First, in developing an MTBF, it must ensure the existence of forecast models of the main macroeconomic indicators that provide relevant information for everyone involved in the budget process. Secondly, we consider essential to have a medium-term strategy to ensure transparency and predictability in forecasting relevant revenues, public spending, budget deficit, public debt, etc..

To increase the quality of fiscal governance in Romania, it should be considered a range of institutional and legislative measures on national fiscal policy. At the institutional level, increasing the quality of fiscal governance becomes the main priority characterized by institutional and legislative measures, such as a new law on fiscal responsibility, developing a long-term fiscal strategy shift to multi-annual budgetary programming by implementing a medium-term budgetary framework, the introduction of strict fiscal rules, the establishment of an Independent Fiscal Council etc. To ensure the effectiveness and efficiency of the measures to be taken, it is necessary that the fiscal and budget strategy, the medium-term budgetary framework and Independent Fiscal Councils are governed by laws adopted by Parliament.

Romania has failed so far to introduce a medium-term budgetary framework because annual budgets were not coordinated with a multi-year budget framework, and also given the political instability which did not ensured consistent application of fiscal policies. Another impediment to the successful implementation of a medium-term budgetary framework is given by the lack of a clear strategy in the medium term public finance in particular the system of taxes. The importance of fiscal strategy on the medium term is the premise of achieving realistic macroeconomic forecasts that provide an accurate view of key economic indicators, enabling the design of budgetary processes, the introduction of fiscal rules and annual budgets connection to the medium-term budgetary.

Given the specificity of the Romanian economy and the main vulnerabilities of the Romanian fiscal system, we believe that for our country would fit a fixed MTBF ceilings on budgetary indicators, and sliding on the horizon operation, adding at the end of each year the new year in the time horizon. We believe that successful implementation of fiscal rules can be made under an existing medium-term fiscal framework and budgetary procedures to ensure fiscal discipline.

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